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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 187

THE G AND K MANUFACTURING COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

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PETITION.

To the Honorable, the Chief Justice, and the Associate Justices of the Supreme Court of the United States:

The petitioner, The G and K Manufacturing Company, by its attorneys, Llewellyn A. Luce and Claude I. Parker, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit, entered in the above entitled cause on April 2, 1935, affirming an unpublished decision of the United States Board of Tax Appeals, and reported in 76 F. (2d) 454.

Questions Presented.

1. Whether the transaction of November 12, 1929 between the petitioner corporation and the Kraft-Phenix Cheese Corporation, as a result of which the petitioner received $200,000 in cash and 17,250 shares of restricted common stock in the Kraft-Phenix Cheese Corporation in exchange for substantially all of petitioner's assets, constituted a reorganization within the meaning of Section 112 (i)(1) of the Revenue Act of 1928.

2. Whether an agreement not to sell or transfer common stock of a corporation upon its receipt in exchange for property should, as a *matter of law,* be disregarded in determining the fair market value of said common stock.

3. Whether the effect of an agreement not to sell or transfer stock upon the fair market value of said stock is purely a question of law or a question of fact to be determined by the testimony of witnesses.

Statement.

The Commissioner of Internal Revenue proposed a deficiency of $19,805.16 for the calendar year 1929 against this petitioner as a result of a transaction on November 12, 1929, by which petitioner transferred its business and substantially all its assets to Kraft-Phenix Cheese Corporation in exchange for $200,000 cash and 17,250 shares of common stock of Kraft-Phenix Cheese Corporation. In the agreement entered into between the parties on November 12, 1929, the petitioner agreed that it would not sell or assign the said 17,250 shares of common stock in Kraft-Phenix Cheese Corporation for a period of ninety days without the consent of a corporation which was a subsidiary of and wholly owned by the Kraft-Phenix Cheese Corporation. The restriction on sale was indorsed on each stock certificate received by petitioner. It was also agreed that if, during said period of ninety days, or within ninety days thereafter, the holders of a majority of the common stock

of the Kraft-Phenix Cheese Corporation should deposit said common stock pursuant to a plan of reorganization, merger or consolidation, the petitioner would in like manner deposit its holdings of common stock in Kraft-Phenix Cheese Corporation.

The petitioner remained in existence after the transfer of its assets and during May of 1930 the Kraft-Phenix Cheese Corporation *was merged* with National Dairy Products Corporation. During May of 1930, the petitioner, pursuant to the agreement of November 12, 1929, together with the other holders of common stock in Kraft-Phenix Cheese Corporation, exchanged each share of Kraft-Phenix Cheese Corporation stock for $25.00 par value of 5¼% gold debentures due in 1948 and one-half share of common stock of National Dairy Products Corporation.

The petitioner appealed to the United States Board of Tax Appeals from the determination of the Commissioner, contending: (1) That the transaction by which it exchanged substantially all its assets for cash and restricted common stock was a reorganization; (2) That the restricted common stock which could not be sold for a period of ninety days did not have a fair market value on November 12, 1929 in excess of $4.00 per share.

At the hearing before the Board two witnesses for the taxpayer, experienced in the buying and selling of securities of the sort under consideration, testified that the restricted common stock received by petitioner had no fair market value during the months of November and December, 1929, and that it could not have been sold for more than one-tenth of the list price of the unrestricted common stock.

This testimony was uncontradicted and no other evidence on the point was introduced except a stipulation between the parties to the proceeding showing the list price on the New York Stock Exchange of the unrestricted stock of Kraft-Phenix Cheese Corporation during the period from November 1929 through February, 1930.

At the hearing before the Board the Commissioner contended: (1) That the transaction between the petitioner and Kraft-Phenix Cheese Corporation was a sale, not a reorganization; (2) That the agreement not to sell and the restriction placed upon each share of common stock received by the petitioner had no bearing upon the fair market value of said common stock which, according to the Commissioner, had the same fair market value of $30.43 per share as the unrestricted stock of Kraft-Phenix selling on the New York Stock Exchange.

In an unpublished memorandum opinion entered April 16, 1934, the United States Board of Tax Appeals upheld the Commissioner's determination.

The Board relied on its decision in *Minnesota Tea Company*, 28 B. T. A. 591 and *John A. Nelson Company*, 28 B. T. A. 529 and held there was no reorganization chiefly because the petitioner remained in existence after the transfer of its assets.

The Board ignored the uncontradicted testimony of the petitioner's witnesses and held that the restricted stock had a fair market value of $30.43 per share on November 12, 1929 and that the restriction upon the sale of the stock received by petitioner had, as a matter of law, no bearing upon its fair market value.

Upon review, the memorandum opinion of the Board was affirmed by the United States Circuit Court of Appeals for the Fourth Circuit.

Jurisdiction.

The opinion and judgment of the United States Circuit Court of Appeals for the Fourth Circuit was entered on April 2, 1935 and the opinion is reported in 76 F. (2d) 454. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Specification of Errors.

The Honorable Circuit Court of Appeals erred:

1. In holding that the transaction by which the petitioner exchanged substantially all its assets for cash and stock in the Kraft-Phenix Cheese Corporation was a sale and not a reorganization.

2. In holding as a matter of law that the agreement of petitioner not to sell the common stock received by it had no bearing upon the fair market value of said stock and should not as a matter of law be considered in determining the fair market value of the common stock received by petitioner.

3. In holding that the effect of the agreement not to sell, upon the fair market value of the stock received by petitioner, was a question of law rather than a question of fact to be answered by the testimony of witnesses.

Reasons Relied on for Allowance of the Writ.

1. Four decisions (including the case at bar) on the question of reorganization have recently been entered by the Circuit Courts of Appeals and these decisions are in sharp conflict. The decisions are as follows:

John A. Nelson Company v. *Commissioner*, February 23, 1935, 75 F. (2d) 696 (C. C. A.-7) affirming the decision of the Board in 28 B. T. A. 529; holding that there was no reorganization and cited by the United States Circuit Court of Appeals for the Fourth Circuit in the case at bar.

John J. Watts v. *Commissioner*, March 4, 1935, 75 F. (2d) 981 (C. C. A.-2) reversing 28 B. T. A. 1056, and holding that there was a reorganization.

Minnesota Tea Company v. *Commissioner*, March 25, 1935, 76 F. (2d) 797 (C. C. A.-8) reversing 28 B. T. A. 591 and holding that there was a reorganization.

The present case, April 2, 1935, affirming memorandum opinion of the Board of Tax Appeals and holding that there was no reorganization.

In each of the above cases, the effect of absence of stock control over the transferee corporation and of the continued existence of the transferor were the vital points.

The Second and Eight Circuits held these factors to be immaterial under the language of the statute, in determining whether a reorganization took place. The Fourth and Seventh Circuit held the other way.

In its memorandum opinion in this case the Board cited its decisions in *John A. Nelson Company,* 28 B. T. A. 529, and *Minnesota Tea Company,* 28 B. T. A. 591, in support of its position that there was no reorganization here. The Seventh Circuit affirmed the Board in the *Nelson* case and the Eighth Circuit reversed the Board in the *Minnesota Tea* appeal.

Counsel is advised that the Commissioner is filing with this Honorable Court a Petition for Certiorari in *Minnesota Tea Company* v. *Commissioner, supra,* and is relying upon the decision of the Fourth Circuit in the instant case as being in conflict with the decision of the Eighth Circuit in the Minnesota Tea case.

2. The decision of the Circuit Court in the instant case is contrary to the principles enunciated by this Honorable Court in *Pinellas Ice and Cold Storage Company* v. *Commissioner,* 287 U S. 462. Reorganization was there said to exist if one corporation acquired substantially all the assets of another, and the stockholders of the transferor had a continuing interest in the transferee. The decisions of the Seventh Circuit in *John A. Nelson* v. *Commissioner, supra,* and the Fourth Circuit here would add to the requirements of reorganization the necessity of control by the transferor over the transferee or the dissolution of the transferor or both. In the instant case the petitioner did not dissolve but maintained a continuity of interest in the business of its transferee by receiving and holding in ex-

change for its (petitioner's) assets 17,250 shares of common stock in the transferee corporation.

3. On page 7 of its opinion in the instant case the Honorable Circuit Court of Appeals found in part as follows:

> "Two witnesses for the taxpayer at the hearing before the Board, experienced in the business of buying and selling securities of the sort under consideration, testified that the restricted stock had no fair market value during the months of November and December, 1929, and could not have been sold for more than one-tenth of the list value, or approximately $4 a share. This testimony was uncontradicted, and no other evidence on the point was introduced other than the stipulation of the parties as to the average price on November 12, 1929, and the price range thereafter as hereinbefore set out."

Nevertheless the Court disregarded the testimony of these witnesses and held as a matter of law that a voluntary agreement not to sell need not be considered in arriving at the fair market value of stock.

The Circuit Courts of Appeal have consistently held that the fair market price or value of stock at a particular time is a question of fact to be determined from all the circumstances.

Heiner v. *Crosby* (C. C. A. 3) 24 F. (2d) 191;
Walter v. *Duffy* (C. C. A. 3) 287 Fed. 41, 45;
O'Meara v. *Commissioner* (C. C. A. 10) 34 F. (2d) 390;
Rogers v. *Strong*, 72 F. (2d) 455.

The various Circuit Courts of Appeal have held in a long line of decisions that it is reversible error for the United States Board of Tax Appeals to disregard the unrefuted and uncontradicted testimony of taxpayers witnesses.

Buena Vista Land and Development Company v. *Lucas* (C. C. A. 9), 41 Fed. (2d) 131;
Citrus Soap Company of California v. *Lucas* (C. C. A. 9), 42 Fed. (2d) 372;

Royal Packing Company v. *Commissioner* (C. C. A. 9), 22 Fed. (2d) 536;
Planters Operating Company v. *Commissioner of Internal Revenue* (C. C. A. 8), 55 Fed. (2d) 583;
Boggs and Buhl v. *Commissioner* (C. C. A. 3), 34 Fed. (2d) 859;
Chicago Railway Equipment Company v. *Blair* (C. C. A. 7), 20 Fed. (2d) 10;
Washburn v. *Commissioner* (C. C. A. 8), 51 Fed. (2d) 949;
Dempster etc. Company v. *Burnet* (Ct. Appl. D. C.), 46 F. (2d) 604;
Conrad and Company v. *Commissioner* (C. C. A. 1), 50 Fed. (2d) 576;
Pittsburgh Hotels Company v. Commissioner (C. C. A. 3), 43 Fed. (2d) 345.

It is respectfully submitted that the decision of the Honorable Circuit Court in affirming the Board in a disregard of the petitioner's uncontradicted testimony is in conflict with all of the above decisions of the various Circuit Courts of Appeal and that the effect of a restrictive agreement is a question of fact; not of law.

4. The questions here at issue involve important principles of tax law.

The question of corporate reorganization and what constitutes the same has continually been a vital one both from the standpoint of taxpayers and the Commissioner. There are now pending many cases before the Board of Tax Appeals and the Courts on the question of reorganization. For instance, *Helvering* v. *J. M. Harrison* is now before the Sixth Circuit on appeal from 30 B. T. A. 966 and *Helvering* v. *Marjorie C. Langworthy* is pending in the Third Circuit on appeal from 30 B. T. A. 1217 (styled John S. Woodward before the Board). As set forth hereinbefore the Courts have reached conflicting conclusions upon the question of reorganization here involved and it is proper that the points at issue be finally decided by this Honorable Court.

The question of the disregard by the Board of the uncontradicted testimony of taxpayer's qualified witnesses is of the greatest importance, especially when as in this case there is no other testimony upon the point and inferences must be relied upon to reach a conclusion contrary to the testimony.

The procedure before the United States Board of Tax Appeals affords the taxpayer a remedy to contest the determination of the Commissioner. The Honorable Circuit Court here found that the petitioner's witnesses were experienced and that their testimony was uncontradicted. To disregard the testimony of such witnesses especially when their evidence is unrefuted is not consonant with the great remedial purposes of the legislation creating the Board of Tax Appeals. *Helvering* v. *Taylor*, 55 S. Ct. 287.

The question whether the effect of a restrictive agreement upon the fair market value of stock is one of law or fact is important to all taxpayers, both corporate and individual, in view of the great number of stock exchanges which are made throughout the country during each year.

WHEREFORE, it is respectfully submitted that this petition should be granted.

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APPENDIX.

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(c) Amount realized.—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) General rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) Exchanges solely in kind.—

* * * * * * *

(4) Same-Gain of corporation.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * * * *

(d) Same-Gain of corporation.—If an exchange would be within the provisions of subsection (b)(4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market

value of such other property so received, which is not so distributed.

* * * * * * * * *

(i) Definition of reorganization.—As used in this section and sections 113 and 115—

(1) The term "reorganization" (means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) Definition of control.—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.